

Public sector fraud  
Identifying the  
risk areas



## In the current climate, where there is pressure to reduce and justify public expenditure, the financial and reputational impact of any fraud affecting a public sector body will be heightened.

The types of fraudulent schemes which the public sector faces are varied and the perpetrators can come from any level in the organisation; from senior management, whose authority makes it easier for them to override controls, to the contract worker facing personal financial pressures, and may be tempted to overcharge for work done. Experience shows that schemes often start small but increase as they succeed.

### Common fraud issues in the public sector

#### Failure to adhere to procurement procedure

This may involve bid rigging or avoiding formal tendering requirements so as to favour a particular supplier. This may be done in return for a direct financial reward, or, as in a case we investigated, because the purchasing manager had a personal preference for a particular technology type and avoided putting significant expenditure requests through a formal tender process. This was in spite of continued complaints from staff at the organisation because the chosen technology failed to meet their requirements.

#### Collusion with external suppliers or creation of fictitious suppliers

Where senior personnel are able to set up and authorise payments to suppliers, there is a risk that the organisation can end up paying for services which it has never received, or paying too much. We investigated an example where significant sums were paid to the overseas-based related party of a senior manager, despite the fact that similar products were available at cheaper prices in Ireland. One way to identify such related party frauds can be to compare the bank account details of suppliers to those of employees and see if there are any matches.

#### Abuse of expense policies

Employees may take advantage of loosely worded policies, or of their ability to authorise their own expenses. In one case, a senior employee had attended courses overseas, but had stayed on at the location after the course had ended, and claimed the hotel and other costs back from his employer. The same individual had made claims for mileage and for train travel to identical locations on the same dates.

#### Misuse of public assets for personal gain

In two cases, we have uncovered instances of employees running private businesses, whilst being employed by, and using the assets of, a semi-state body. In one of these, there was an additional risk to the body because the employee was engaged in illegally copying software.

#### Misreporting of budgets to obtain funding

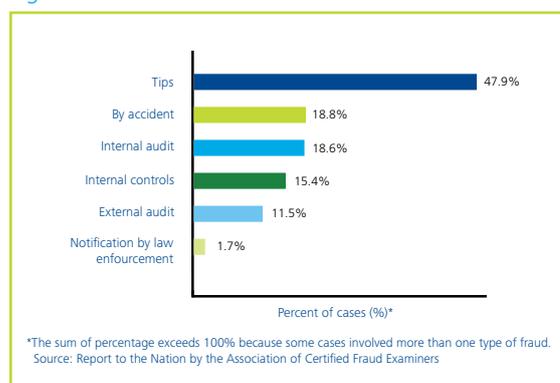
Where funding is under pressure, organisations may be tempted to report results which will maximise their funding, rather than results that properly record their expenditure. The impact of this is that scarce funding may be incorrectly allocated and, as previously outlined by the Comptroller and Auditor General: "Good financial management demands that public funds should only be disbursed as needed. Allocating scarce resources to projects before they are clearly in a position to proceed may unnecessarily delay other projects of equal merit due to a perceived lack of available funding<sup>1</sup>."

#### Overtime or contractor abuse

Employees or contractors can take advantage of weak controls to overcharge for work done. Some simple data analytics tools can help organisations to identify potential over-claims which can then be followed up for investigation with any loopholes being closed off by improved policies and controls.

### How is fraud detected? The importance of whistle blowing

Figure 1



<sup>1</sup> Special Report on General Matters Arising on Audits - published April 2008

## Fraud reduction plans

Public sector bodies can do a lot to reduce the risks of fraud by adopting a clear fraud reduction plan. Ten key issues you should consider when putting in place a fraud reduction plan in the public sector are:

### 1. Tone at the top

Senior management must send out the message that fraud in any form is not going to be tolerated, and lead by example.

### 2. Clearly written policies and procedures

These should spell out carefully and simply what is not allowed and the consequences of violating the rules. In addition, management should consider testing the attitude of staff to ethics by means of regular surveys.

### 3. Allocate responsibility for fraud risk management

To avoid the risk that responsibility falls between managers, the organisation should have a clear fraud risk champion, who is known to all employees.

### 4. Training

A written policy needs to be supplemented by training to ensure that there are no grey areas in regard to acceptable conduct. Online or face-to-face training enables employees to understand how the policy applies in real life situations.

### 5. Whistle-blowing

Encourage employees to highlight potential problems by implementing a mechanism that provides a confidential method to report concerns. As shown in Figure 1, nearly half of all fraud is uncovered by tip-off.

### 6. Implement strong anti-fraud controls

This is just as essential in the public sector as it is for any other organisation. In particular segregation of duties should never be compromised. It is also important to ensure that these controls apply to peripheral areas for example, cafeterias, car parks or other non-core activities.

### 7. Fraud risk management

A regular review of fraud risks should take place to identify where the organisation faces the greatest risk of loss. Control and audit resources can then be devoted to the areas where they will have the greatest impact.

### 8. Enforcement as deterrent

There can be a fear of the negative impact of reported fraud on an organisation, but simply letting the perpetrator resign does little to discourage future wrongdoing by others.

### 9. Paying attention to small transgressions

Since fraud generally starts small and can grow over time, addressing even the smallest transgressions can be instrumental in preventing future scandals. It also sends out the message that fraud is not acceptable.

### 10. Prevention first

Once fraud has been committed and the money spent, it is difficult to recoup the losses. It is far better to keep theft from happening in the first place.

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Keeping these factors in mind when confronting fraud at your organisation can help enhance deterrence and prevent future problems.

## What to do if fraud is committed

If fraud is suspected, a swift and thorough response is needed to investigate the allegations confidentially and in compliance with all relevant legislation.

Firstly, documentary and electronic evidence needs to be gathered and analysed; secondly, it is important to interview people who may have information; and finally, once the fraud has been investigated, strong controls need to be implemented to prevent it happening again.

### Gathering and analysing the evidence

Evidence must always be gathered to the highest legal standards so that it can subsequently be relied upon should action be taken. In today's environment the majority of information is available in electronic form and forensic technology experts need to be involved in extracting it.

In particular, emails and deleted files which can be recovered are key sources of information for the investigator. People are far more likely to leave a trail of evidence in electronic form, than in terms of documents.

Once the information is available there are a variety of data analysis techniques which can be used to identify anomalies in the data which might be indicative of fraud.

### Conducting interviews

Fraud does not happen in a vacuum and it may be that there were suspicions surrounding the fraudster. In most cases there is somebody who knew or felt that something was not right.

In one case we investigated, an individual in the fraudster's department had maintained a detailed log of suspicious actions going back over several years, but had not brought this to the attention of senior management because they were afraid of the consequences.

Interviews need to be conducted carefully with due regard for the rights of the suspect and in line with the organisation's Human Resource policies and procedures. Ultimately interviews can provide very valuable evidence and information to inform the investigation.

### Improving controls

Once fraud is discovered, controls need to be reviewed to identify weaknesses and introduce improvements. A strong anti-fraud control programme, which threatens potential fraudsters with a real risk of detection, means that people will think twice before attempting to commit a fraud.

Similarly, the regular use of a fraud and ethics survey can be a powerful way to:

- Promote positive ethical behaviour and set an anti-fraud tone from the top
- Raise employee awareness of fraud risks and company policy
- Help identify risk areas and optimise the allocation of anti-fraud resources
- Provide employees with a 'soft' form of whistleblowing which allows them to identify issues for further investigation, without having to make specific allegations against individuals
- Undertake a year on year measurement of employee attitudes to fraud

### Conclusion

Scarce resources, weaknesses in internal controls and senior management override can make any organisation in the public sector vulnerable to fraud. Whether overstating overtime, colluding with suppliers or straightforward misappropriation of money or assets, the opportunities to commit fraud exist.

Rigorous investigation of suspicions of fraud, through proper gathering of evidence, data analysis and interviewing of witnesses, is crucial. These efforts should be supplemented by implementing robust controls and enforcing a strong anti-fraud culture including enforcing penalties against those who violate trust.

At a time of increased economic pressure on the public sector, personal financial pressures on individual employees and continued public scrutiny of all expenditure, the risks to public sector organisations from instances of fraud are perhaps higher than ever.

# Contacts

Our team at Deloitte can help public sector bodies deal with fraud issues by:

## Assessment

- Helping organisations to identify the fraud risk profile of their business and identify the highest risks
- Assisting with planning and conducting a fraud and ethics survey using our DTermine survey tool which provides valuable insights from staff and management on the ethical culture

## Prevention

- Working to design, develop and implement fraud prevention policies, procedures and strategies
- Helping to strengthen your defences against attack from employees or third parties

## Detection

- Investigation of suspicions of misconduct, gathering the relevant evidence to provide you with the facts
- Using data analytic tools to identify potential fraud or controls weaknesses by systematic review of large volumes of data for unusual transactions

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